FINANCIAL INSTITUTIONS COMMITTEE
Business Law Section, State Bar of California
Committee Website -- Click Here

Minutes of the Meeting of January 9, 2007

Committee Members Present:
Rosie Oda, Chair;
Meg Troughton, Vice Chair;
Bruce Belton, Secretary;
Michael Abraham;
Laura Dorman;
Andrew Druch;
James Dyer;
Andy Erskine;
Elaine Lindenmayer;
Todd Okun;
Alan Ono;
Richard de la Pena;
Mary Price;
Joseph Sanchez;
Brad Seiling;
Robert Stumpf;
Shirley Thompson;
Keith Ungles; and
Mike Zandpour.

Advisory Members and Others Present:
Steve Balian;
Clay Coon;
Steve Dimmick;
John Hancock;
Robert Mulford;
Meghan Mussleman;
Tapan Munroe;
Michael Occhiolini;
Isabelle Ord;
Mike Ouimette;
Neil Rubenstein;
Steve Strange;
Steven Takizawa;
Gerry Tsai;
Chuck Washburn; and
Maureen Young

Committee Members Absent:
Linda Iannone;
Randy Kennon;

Teryl Murabayashi;
Russ Schrader;
Will Stern; and
Richard Zahm

Call to Order: Our Chair Rosie Oda of Pillsbury Winthrop Shaw Pittman LLP called the meeting to order at 9:30 a.m.

1. Roll Call and Introductions: Rosie welcomed the Committee Members and the Advisory Members and asked each person to identify themselves and where they worked. Rosie advised the Committee that the Legislative Day scheduled for Sacramento on February 13 has been postponed, perhaps for March but this is not yet confirmed. Thus, our February meeting will be held at the regular locations not in Sacramento as previously scheduled. Also Rosie circulated the constituency list of approximately 600 Section members but did not want to circulate that by email. Finally, Rosie reported that the Bar was short an employee so that the bios and photos were not yet posted to the Committee website.

2. Approval of December 2006 Minutes: The Committee approved the minutes of the December 12, 2006 meeting.

3. Economic Outlook for 2007: Dr. Tapan Munroe, PhD made a presentation to the Committee on the economic outlook for California in 2007. A copy of the slide presentation is attached.

Dr. Munroe reported as follows. It is a difficult task to report on the entire State of California given the significant differences between geographic regions. California, its regions and cities operate within an extremely competitive world economy. California is one of the largest economies in the world, perhaps the 6th, 7th or 8th largest. Performance of the national economy in 2006 was good in light of the challenges. California, in 2006 has slowed down significantly. The slow down in the housing sector is more like a soufflé in which the air is slowly escaping (versus a burst bubble). China and India also play very important roles, being the 4th and 5th largest worldwide economies, respectively. The US has experienced remarkably low inflation rates due in large part to low interest rates and inexpensive imports (primarily from China), and rising productivity. After the dot-com "bomb" there was a brief recession. There was a slow recovery which peaked in 2004, then slowed down, and 2006 was very respectable for the US (but California was adversely affected by the housing slowdown).

2007 is expected to be slower. 2-1/2% growth for the national economy and California is expected to be 1.5% to 1.6% growth. The term "recession" should not apply to the slow down, but in part this depends on the energy market. California's economy, like most modern economies, is predominantly a services economy. A misconception about a service economy is that it consists of low-wage jobs. This is not true. Most large corporations and employers are service based operations.

Most California population growth over the next 10 years should take place in the Central Valley which is also where there will be additional economic activity. San Diego should also be a boom growth area. LA basin and SF Bay Area should grow at slower rates. This growth will also impose challenges on air quality, transportation, and related issues. The fastest growing Bay Area county in 2006 was Contra Costa; Santa Clara was second (despite the economic slow down in dot-com business). This growth should continue the next few years, but at a slightly slower rate.

There has been significant job growth in the last five years, especially in the Sacramento region and San Joaquin Valley. For quality of economic growth, the San Diego region is the standout. San Diego did not have a recession in 2001 and should continue as an extraordinary story, but somewhat slower growth in the next few years.

The center of gravity for California is shifting from the LA basin, a little bit to the SF Bay Area. Corporate performance in the Bay Area has been very strong in the last few years. Job growth has not been that strong but should improve. Web 2.0 business should help in this improvement and are doing very well, including Google. But these companies are based primarily on advertising, the revenues from which are notoriously fickle. Another development is in clean energy, in which Silicon Valley is taking huge strides to become the leader. This includes solar and biomass.

For total employment outlook, the LA basin should have the greatest job growth, but also is a very large percentage of the total.

Housing has been the major news item and concern. But it is not a bust, rather a soufflé where the air is leaking slowly. Better termed, “a correction.” Most people are focusing on last year and because those increases didn’t repeat themselves, sellers are disappointed. Sacramento has had significant problems due in large part to being over built and over speculated. Some areas even increased by small percentages. In the Bay Area, prices went down in some fringe areas, but in San Francisco, Santa Clara and Alameda counties values nevertheless increased in 2006. The correction is probably healthy for the economy. Interest rates helped to drive some of the slow down but there are other economic factors as well.

Energy use in California will be a significant factor in the future. Oil use has got to change in order to continue with growth. Some companies are now focusing on making positive changes, especially in the Bay Area. As en example, the data indicates that it is economically viable to construct “green” buildings. Technology advances will make this possible. US dependence on oil imports from some of the most dangerous places in the world puts our economy at significant risk.

Overall 2006 looks like a modest year. Inflation remains remarkably contained thanks in part to recent changes in oil prices. Despite challenges, last year we did very well and barring international upheaval, 2007 should be a good year. SF Bay Area is on a rising curve again.

4. Countrywide Bank, N.A. Proposed Conversion to a Federal Thrift: Andrew Erskine of Countrywide Financial reported on the Countrywide Bank conversion to a Federal Thrift as follows: A decision has been made to convert to a federal savings bank charter. Although Countrywide bought a bank, it is for the most part a residential mortgage lender. The Bank has not traditionally had business transaction deposits but has some CD, passbook and money market deposit accounts. The Bank has never diversified outside residential and commercial real estate lending. In sum, the Countrywide looks more like a thrift, rather than a bank. Initially Treasury Bank was purchased as a state chartered bank in 2001 and immediately converted to a national bank. The question whether Countrywide should have an OTS charter has been under consideration for some time.

In 2006, this reevaluation was renewed and focused at a more senior level. Discussions were had with outside counsel who initiated contact with senior personnel at OTS holding an extensive number of meetings to develop a relationship with OTS, to describe Countrywide’s business, and get a feel for the OTS general approach and views on important business issues. An issue by issue matrix was prepared for internal use comparing regulatory regimes of OTS and FRB and assessing the impacts of the potential change on Countrywide's business activities. Countrywide concluded that current business being conducted could continue as a savings and loan holding company. Based on that information and further discussion, the directors voted to convert to a federal savings bank.

Principle drivers were: (1) OTS historical mission has been to support residential real estate lending; (2) OTS regulation would result in a unitary regulator for both the depository and the holding company operations. Countrywide is unique in the banking industry in that it has it's most significant production facility is wholly outside the Bank as a holding company subsidiary. Other players in this area have facilities outside their banks, but the majority are inside the banks or an operating subsidiary.

One of the effects of converting to a thrift is that BASEL II will become applicable at a much later date because the $250 billion asset threshold for a bank holding company is based on consolidated company assets. For a thrift holding company it is based on the thrift assets alone. Another aspect of the conversion is that the holding company capital requirements imposed on thrift holding companies are related more to economic versus risk-based capital or leveraged capital applicable to bank holding companies. Third, relating to non-traditional mortgage product guidance, the OTS intends to interpret guidance on this issue in a manner different from the OCC.

Also, BSA/AML compliance programs are not mandatory for a thrift holding company, at least not to the extent imposed on bank holding companies, although such a program, including the filing of SARs would be advisable from a risk-management perspective. Thrifts can also be involved in real estate development and brokerage activities to a greater extent than bank holding companies. Foreign branches are not authorized by the OTS. There were also discussions about preemption. OTS preemption is at least arguably stronger, specifically the *Delaquesta* case, even if the US Supreme Court in the *Watters* case rules against preemption.

The application was filed in early December. Some letters from community groups were received in response, and one protest. Countrywide anticipates that the application will be approved sometime during the first quarter of 2007.

5. SEC Proposed Regulation R: Mike Ouimette of Pillsbury Winthrop LLC reported on the SEC proposal for Regulation R, as follows:

Newly proposed Regulation R will govern the securities brokerage operations of banks and federal savings associations and other savings associations with insured deposits. Absent an exception, under Section 15 of the Securities Exchange Act, persons engaged in the securities brokerage business must register as a broker and be subject to examinations. Prior to the Gramm-Leach-Bliley Act of 1999, banks enjoyed a blanket exemption from the definition of broker under the Exchange Act. After the GLB Act, this blanket exemption was generally restricted to 11 bank brokerage operations enumerated under Section 3(a)(4)(B) of the Exchange Act, as added by the GLB Act. More than 5 years ago, the SEC attempted to promulgate Regulation B to provide interpretive, exemptive and enacting regulations for the GLB exemptions. The SEC's proposed Regulation B was met with significant opposition by the banking industry. Due to this opposition, final Regulation B was never issued and the blanket exemption for banks prior to GLB was extended by the SEC.

To end the deadlock, Congress passed the Regulatory Relief Act which was signed into law by President Bush in October 2006. This Act required the SEC and Fed to promulgate joint regulations to replace Regulation B within 180 days. These joint regulations were proposed in December 2006 and are known as Regulation R. Proposed Regulation R will end the blanket exemption for bank brokerage activities and enact the GLB exemptions and interpret certain terms of section 3(a)(4)(B) of the Exchange Act. Regulation R will also provide additional regulatory exemptions which are intended to allow traditional bank brokerage operations to continue while also attempting to prohibit a bank from running a brokerage operation.

Proposed Regulation R addresses four of the eleven GLB statutory bank exceptions to the general broker definition contained in Section 3(a)(4):

- third-party brokerage arrangements (the so-called networking arrangements);
- trust and fiduciary activities;
- sweep accounts; and
- safekeeping and custody activities.

Proposed Regulation R also would provide banks with a number of other related rule-based exemptions addressing:

- foreign securities transactions;
- securities lending transactions;
- transactions in investment company securities; and
- potential voidability of bank contracts under Section 29 of the Exchange Act.

Comments on Proposed Regulation R are due no later than March 26, 2007. The SEC has also extended the temporary exemption of banks from the definition of “broker” under Section 3(a)(4) of the Exchange Act until July 2, 2007, the proposal would extend the blanket exemption to banks until the first day of a bank’s first fiscal year commencing after June 30, 2008. On the same date, the SEC separately published a companion release proposing certain other rules and rule amendments relating to banks’ securities activities; this presentation covered only the proposed Regulation R, not the separate SEC proposals set forth in the companion release.

Maureen Young reported that the Regulatory Relief Act, although requiring draft regulations with a set time, contained no statutory requirement that the regulations be finalized.

6. Remote Capture and Proposed Amendment to Reg E and NACHA’s Operating Rules: This item was deferred to the February agenda.

7. Three Recent Cases: Bob Mulford provided the following written report on cases of interest to the Committee:

<u>A common fraud scenario</u>: Person receives one or more cashier’s checks or official checks, with instructions to wire transfer some of the proceeds to another bank – likely in a foreign country. Customer may ask if check is good, and be told it is, especially if bank policy is not to impose holds on cashier’s checks or official checks. After funds are transferred, the “good” check is returned as counterfeit. Bank takes loss if customer is not good for the chargeback, and perhaps even if he is, if he sues for misrepresentation.

Valley Bank v. Hughes, 2006 WL 3247316 (Mont., Nov 8, 2006), involved such a suit by a man victimized by a Nigerian scam. He claimed, inter alia, bank negligence both in processing the check and in misrepresenting whether the check was good. (He claimed that he asked when the funds would be available, since he would be transferring a large sum, and was told “official checks, same as cash. You can do whatever you want to do.”)

The lower court held that the UCC displaced all his common law claims. The Montana Supreme Court agreed as to the claim for negligent processing, since UCC 3-103(a)(7) deals specifically with bank ordinary care in check processing. But since nothing in the UCC deals specifically with misrepresentations about check processing, his common law misrepresentation claim was not preempted.

Compare *Keybank, N.A. v. Woodham Asset Mgmt. Corp.*, 131 Wash.App. 1062, 2006 WL 618887 (Mar. 13, 2006), denying a claim by a bank customer that a bank officer had misrepresented the status of a cashier’s check that turned out to be counterfeit. Since the bank-depositor agreement provided that all deposits are conditional and subject to proof, “a conversation by a bank employee does not alter these terms. [The depositor] had no reasonable basis for relying on a statement by a bank employee that contradicted the express terms of the Account Agreement.”

This case also involved a deposit agreement clause that allowed for returns for any reason, despite any delays. However, the depositor had not challenged the validity of this language (he argued that he was not bound by the agreement since he did not intend to activate an account when he gave the bank a check he was suspicious about). Also, the case is unpublished, and thus not binding authority under Washington law.

<u>Charging a depositor based on a claim of forged endorsement</u>. In *Chiafolo v. Ridgewood Savings Bank,* 11 Misc.2d 899, 816 NYS2d 324, 58 UCC Rep.Serv.2d 1020 N.Y.Civ.Ct. 2006), one of two joint payees executed an affidavit of endorsement two years after the check has been paid. The payor bank submitted the claim to the bank of deposit, which in turn debited the other payee. Held, endorsement was not forged, and bank of deposit had no right to debit its depositor. All settlements became final when the payor bank kept the check beyond its midnight deadline.

Query of a bank-deposit agreement would justify a late chargeback. Lema v. Bank of America, 826 A.2d 504 (Md.App. 2003) did enforce such an agreement, although three judges dissented. Keybank/Woodham Asset Mgmt., above, also did so, but the depositor did not contest the enforceability of the agreement, and the case is unpublished.

<u>Who is liable for a bum check, when the original has been destroyed</u> so one cannot determine whether the check has an altered payee (in which case the bank of deposit takes the loss) or the check is completely counterfeit (loss falls on payor bank). Last year we noted *Wachovia Bank, N.A. v. Foster Bankshares, Inc.,* 457 F.3d 619 (7th Cir. 2006), which put the loss on the bank of deposit (Foster). Although the paying bank was the one that had destroyed the original, the bank of deposit had not shown that duplicating the entire check, rather than merely altering the payee’s name on the original check, had become a common method of bank fraud.

Now a panel of the 4th Circuit has weighed in, and come to the opposite conclusion. In *Chevy Chase Bank, FSB v. Wachovia Bank, N.A.,* 2006 WL 35232503 (4th Cir., Dec. 6, 2006), Wachovia was again the payor bank that had destroyed the original check and retained only a digital copy. This time the court concluded that Wachovia could not shift the loss to the bank of deposit, since Wachovia had failed to prove that the check had been altered as to payee instead of being counterfeited. The majority completely ignored the 7th Circuit Wachovia/Foster Bankshares decision, but the dissent cited it, complaining of the "needless conflict with our sister circuit … in an area of the law where the need for national uniformity is greatest." But the case is unpublished, and thus not binding precedent in the 4th Circuit.

<u>Suspicious Activity Reports</u> are supposed to be secret, but a bank that was victimized by a kiting scheme nonetheless accused another bank of negligence in not filing a SAR. *Commerce Bank/Pennsylvania v. First Union Nat'l Bank,* 2006 WL 3072002 (Pa Super., Oct. 31, 2006). The court rejected the claim. The court also followed the majority rule in finding that one bank has no duty to warn other banks of suspected kiting activity.

8. Financial Action Task Force Reports: Misuse of Corporate Vehicles and New Payment Methods: Maureen Young of Bingham McCutchen LLP reported on four related AML developments. There are two reports from the Financial Action Task Force; one on NPM (new payment methods) and another on misuse of corporate vehicles, including trusts and company service providers. There is a related development from FinCEN on the risks of domestic shell companies in AML. And a development on Capitol Hill regarding potential reform regulation for registration and reporting of corporate information on a state basis.

Under BSA regs there are some financial institutions that are already highly regulated and there are others for which FinCEN has recently rolled out regulations, e.g., insurance companies, dealers in precious gems and metals and jewelry companies. There are other financial institutions not defined in the Act for which there are no regulations, e.g., finance companies. One of the consequences is that law enforcement has been complaining that there are holes in the anti-money laundering regulations. US law enforcement has been reviewing bank involvement with different types of corporate entities, and those states with less stringent filing requirements may be viewed as higher risk jurisdictions.

The Financial Action Task Force report on new payment methods concluded that although review of traditional means of funds transfer were sufficiently reviewed, Banks could be doing better with new payment methods, e.g., stored value cards being used outside traditional banking community purposes.

The Financial Action Task Force, an international group, has agreed to develop common standards for the tracking of AML and they produced recommendations for those countries that participate in the Task Force. The recent reports focus on NPM and the regulation of so-called "shell" companies which are not currently regulated. Our government's response was the issuance of a FinCEN report on shell companies. FinCEN issued an advisory which may end up as regulation that applies specifically to companies that previously were not required to have AML programs.

Some risks that have been identified include that shell companies are being used for illicit activities, e.g., credit card fraud and wire transfers. The recommendation is to require these previously unregulated companies to adopt AML programs. The Financial Action Task Force report contained a lengthy list of requirements that would need to be reviewed by company managers.

One month after the Financial Action Task Report was issued, the suggestion on Capitol Hill was to require that States do certain things and require ongoing reporting and checks on company formation. This would be a significant change for state formed companies.

The other Financial Action Task Force report on new payment methods concluded that these were not sufficiently regulated. The Task Force recommends adoption of various criteria based on identification, value, funding, geographical and usage limits.

9. Legislative Subcommittee – State Legislative Issues: Bob Mulford reported that the Legislature is back in session he did not see any bills pending that appeared to be of interest or concern to the Committee. Nor has the CBA produced any list. He will report again next time.

10. Proposal for Annual Bar Meeting Presentation in September: Meg Troughton, Vice Chair, reported that the issue of data compromise should have a wide audience appeal and proposed that as our topic for the September State Bar meeting. She has already lined up 3 additional speakers. Also reaction to how to react to situations in which data may be lost. Anyone who has interest in joining the panel or suggestions for the list of topics should contact Meg. She expects very good attendance based on this topic.

11. Open Meeting, Other Items of Interest: Meg reported that there was a senior counsel position open at Fannie Mae, but that job was in Washington DC. Meg indicated she would distribute the posting notice to the Committee by email.

The meeting was adjourned at 11:35 am. Next meeting: February 13, 2007.

California
& Regions-2006 & Beyond

January 9th, 2007

presented by

Tapan Munroe, PhD

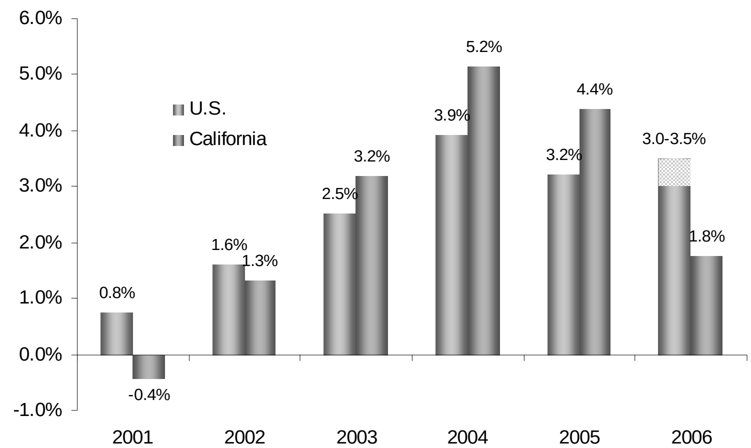
Director,LECG,LLC

Outlook : Global Economies
The U.S. is Leading

	GDP '05	GDP '06	Inflation (CPI) '05	Inflation (CPI) '06
U.S.	***3.5%***	***~3.0***	***3.4%***	***~2.5 - 3.0%***
California	***3.6%***	***~1.8%***	***3.9%***	***~3.6%***
Britain	**1.7%**	**2.1%**	**2.1%**	**2.0%**
France	**1.6%**	**2.0%**	**1.8%**	**1.7%**
Germany	**1.1%**	**1.7%**	**2.0%**	**1.7%**
Euro Area	**1.4%**	**1.9%**	**2.2%**	**2.0%**
Argentina	**8.7%**		**12.3%**	
Brazil	**2.5%**		**5.7%**	
Mexico	**3.0%**		**3.3%**	
Japan	**2.6%**	**2.5%**	**-0.2%**	**1.6%**
China	***9.9%***		***1.6%***	
India	***8.0%***		***5.6%***	

Source: Bureau of Labor Statistics, Economy.com, CIA World Factbook

U.S. & California Economies
Real GDP growth: 2001-06
Expect 2007 to be slower



Tapan Munroe | Source: Moody's Economy.com | January 2007

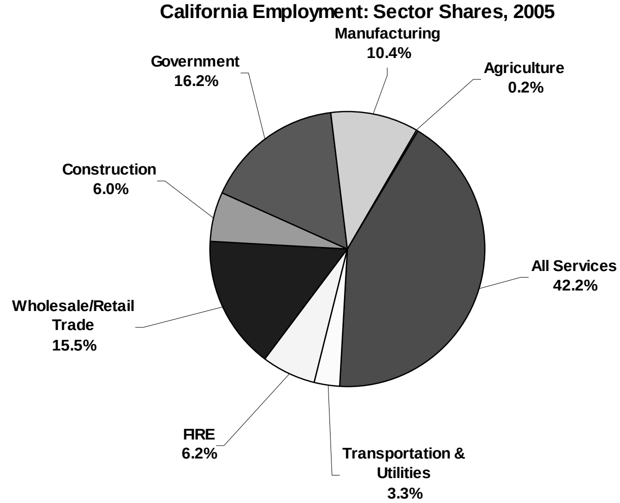
Contra Costa
Median Home Price Changes
Year-over Year: Nov 2005-'06

	Sales	Nov. 06	Year-over Change
	California	**$469,000**	**-23.5%**
	Bay Area	**$616,000**	**-1.4%**
	Contra Costa	**$570,000**	**-0.87%**
South County			
	ALAMO	**$1,450,000**	**16.70%****
	DANVILLE	$977,000	-14.13%
	SAN RAMON	$800,750	-7.64%
West County			
	HERCULES	**$590,000**	**18.00%****
	EL CERRITO	$590,000	-0.84%
	EL SOBRANTE	$572,500	1.33%
	PINOLE	$550,500	1.94%
	SAN PABLO	$462,000	1.99%
	RICHMOND	$450,000	2.86%

Tapan Munroe | November 2006 Data of houses sold - Source: DataQuick | January 2007

California Employment

California Employment: Sector Shares, 2005

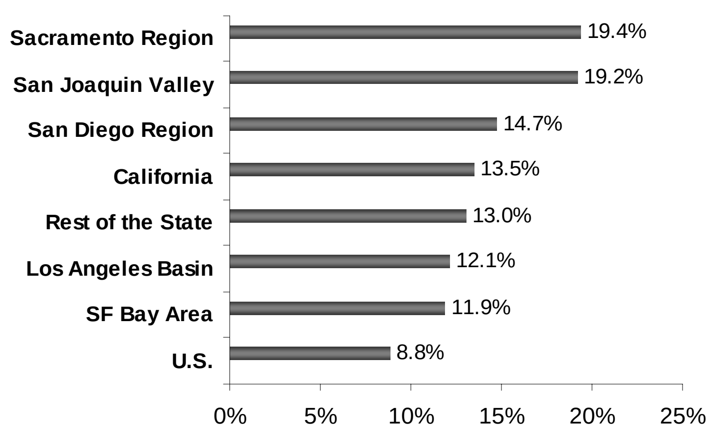


Source: Bureau of Labor Statistics

Tapan Munroe January 2007

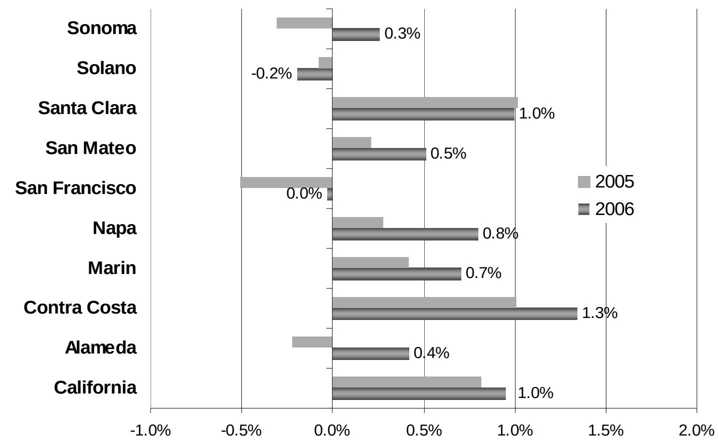
Projected Population Growth: U.S., California & Selected Regions

(Percent Change, 2005-2015)



Tapan Munroe Source: California Dept. of Finance January 2007

Bay Area Population Growth 2005 & 2006



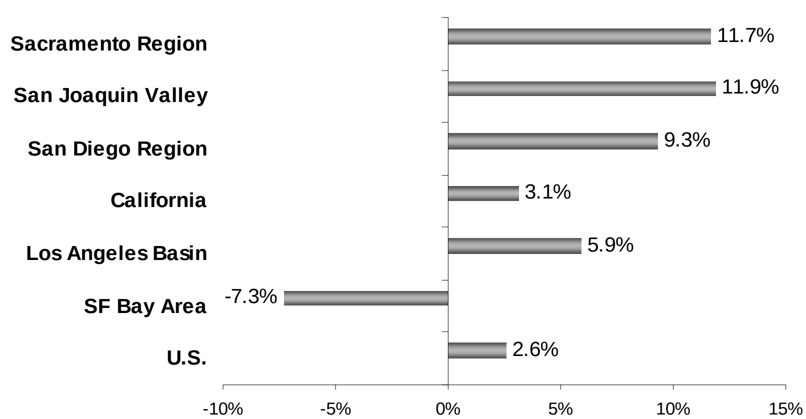
Tapan Munroe

Annual Data, 2005 & 2006 - Source: Moody's Economy.com

January 2007

Non-Farm Job Growth: U.S., California & Selected Regions

(August 2000-August 2006)



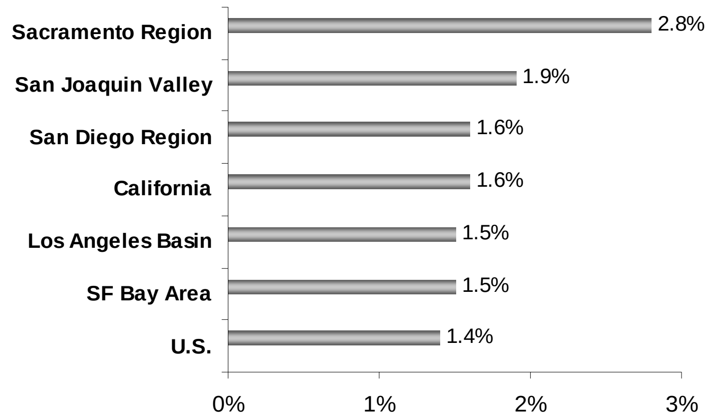
Tapan Munroe

Source: California EDD

January 2007

Non-Farm Job Growth: U.S., California & Selected Regions

(Aug 2006 compared to Aug.2005) (%)



Tapan Munroe | Source: California EDD | January 2007

Total Employment: Forecast U.S., California & Selected Regions

(Thousands of Jobs)

	2005	AvAnn.Growth 2005-2015
California	6,653.6	290.6
Los Angeles Basin	7,788.9	115.2
SF Bay Area	3,562.9	67.9
San Diego Region	1,426.0	29.5
Sacramento Region	1,027.7	22.3
San Joaquin Valley	1,417.2	23.8
Rest of the State	1,530.9	31.8

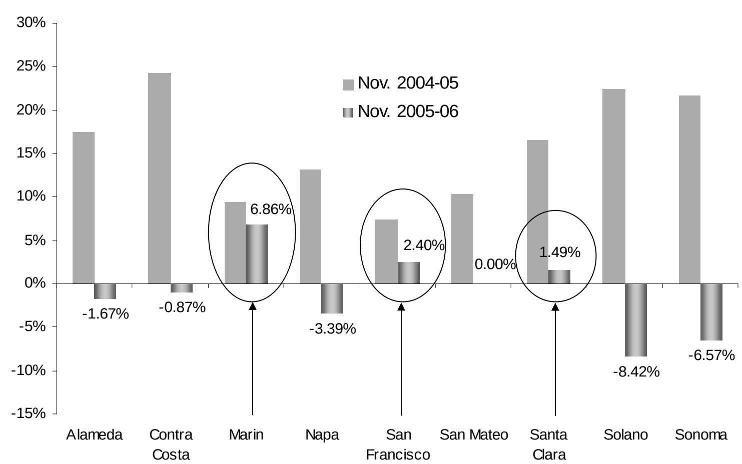
Tapan Munroe | Source: BLS, EDD, CCSCE | January 2007

Median Resale Home Prices: California & Selected Regions

	2000	Aug. 2005	2006	Percent Change 2000-05	Percent Change 2005-06
California	$254,910	$567,320	$576,360	123.0%	1.6%
Orange	$323,487	$716,300	$698,050	121.0%	-2.5%
San Diego	$276,980	$616,870	$598,050	123.0%	-2.2%
San Francisco	$454,470	$730,360	$737,110	61.0%	-2.3%
Central Valley	$143,590	$363,680	$349,890	167.0%	-3.8%
Sacramento	$150,030	$394,450	$378,180	163.0%	-4.1%
Los Angeles	$229,200	$564,340	$589,740	146.0%	4.5%
Santa Clara	$522,500	$760,000	$770,000	46.0%	1.3%

Tapan Munroe — Source: California Association of Realtors — January 2007

Bay Area Home Price Change



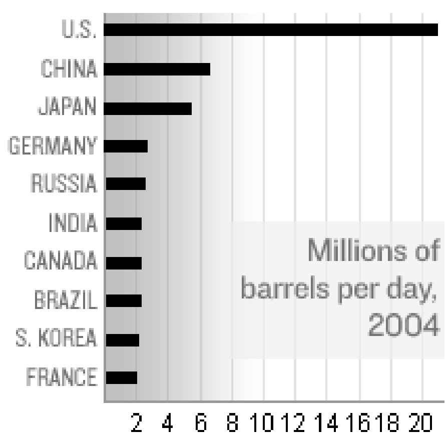
Tapan Munroe — November 2005-2006 Year-over Change - Source: DataQuick — January 2007

Contra Costa
Median Home Price Changes
Year-over Year: Nov 2005-'06

		Nov. 06	Year-over Change
	California	**$469,000**	**-23.5%**
	Bay Area	**$616,000**	**-1.4%**
	Contra Costa	**$570,000**	**-0.87%**
Central County			
	LAFAYETTE	**$1,199,500**	**20.55%****
	MORAGA	**$1,077,500**	**20.80%****
	ORINDA	$963,250	-20.23%
	WALNUT CREEK	$645,000	-7.53%
	PLEASANT HILL	$625,000	3.31%
	CLAYTON	$643,000	-24.84%
	MARTINEZ	$550,000	-0.45%
	CONCORD	$522,500	-0.67%
East County			
	BRENTWOOD	$658,000	-7.97%
	OAKLEY	$528,500	8.08%*
	ANTIOCH	$489,500	-4.95%
	PITTSBURG	$460,000	0.00%

Tapan Munroe November 2006 Data of houses sold- Source: DataQuick **January 2007**

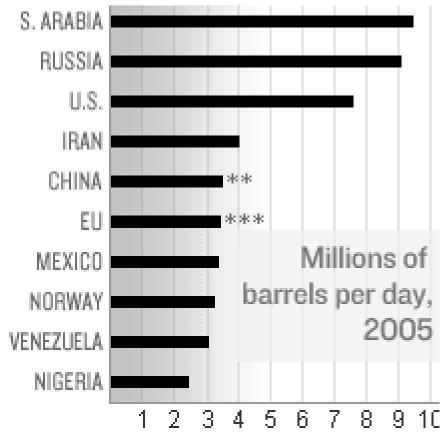
U.S.: Top Gas-Consuming Nation



Source: Energy Information Administration

Tapan Munroe **January 2007**

Top Oil Producing Nations



Source: CIA World Factbook

Thanks!
Tapan Munroe

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www.LECG.com

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or at Tapan@MunroeCconsulting.com